

Federal Reserve Bank of San Francisco

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Controllability

Tucked away in the back of the **Budget of the United States Government** is a table, entitled "Controllable Budget Outlays," which gives some indication of the problems facing the Administration and the Congress in their present budget-cutting efforts. The table shows that roughly three-fourths of fiscal 1974's estimated budget expenditures of \$269 billion are relatively uncontrollable by current legislative actions. These uncontrollable items cover a wide range of Federal activities, from social security benefits to farm price supports to interest on the public debt, and much more besides.

Worsening over time?

The problem of uncontrollability has increased over time, since the percentage of total budget expenditures considered uncontrollable has risen from 61 percent in fiscal 1967 to an estimated 75 percent in fiscal 1974. For civilian outlays alone, the uncontrollable share of the total has jumped from 47 to 67 percent over the same time span.

The concept of controllability cannot always be exactly quantified. For example, items such as social security increases and Federal pay increases are completely uncontrollable while still involved in the legislative process, but they then become virtually uncontrollable when written into law.

Nonetheless, the concept serves to emphasize the important fact that budgetary outlays are not amenable

to large discretionary changes in the short-run. Outlays often flow from contractual and other legal obligations incurred in earlier years, so that payments must be made as the terms of the prior commitments are met. Moreover, outlays under certain open-ended programs depend upon the terms of the authorizing legislation, which often stipulates the rates to be paid and the conditions of eligibility for benefits.

How much involved?

Fixed-cost and open-ended programs may total as much as \$151 billion in fiscal 1974. More than half of that amount would be tied up in \$80 billion of trust fund expenditures, which pay for such things as retirement, Medicare and unemployment benefits. Debt interest is a \$25-billion uncontrollable item, since interest payments must be made to maintain the full faith and credit of the Federal government. Other items of this type include benefit payments of \$9 billion to veterans, \$5 billion to Medicaid recipients, and \$5 billion to military retirees.

Other relatively uncontrollable items in the fiscal 1974 budget would include outlays incurred under pre-1974 legislation—\$22 billion military and \$24 billion civilian—plus about \$4 billion in scheduled pay raises. Thus, the total for all relatively uncontrollable expenditures would mount to \$202 billion, or 75 percent of the Administration's proposed budget total.

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Business & Financial Letter

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Solace to the Treasury

The trust funds—the dominant uncontrollable category—have proved to be a solace to the Treasury in its time of troubles, since they have acted as a strong revenue collector in recent years. Between fiscal 1965 and fiscal 1972, trust-fund revenues have increased 13.4 percent annually, as against a 12.4-percent annual rate of growth of trust-fund benefit payments. In contrast, total civilian expenditures (except trust funds) have risen far more rapidly than non-trust fund revenues over the same time period—10.9 percent versus 7.2 percent annually.

Trust-fund expenditures essentially are self-financing rather than dependent on the general funds of the Treasury. Consequently, although such payments have risen rapidly because of expanded eligibility and increased benefits, the financing mechanism is set to yield more than sufficient revenues to cover those payments. This reflects the many changes in social security financing over the years, including the substantial expansion of covered employment and the continued increases in the social security tax rate and wage base.

Well-financed but regressive

In effect, trust-fund expenditures are increasingly well-financed, while non-trust fund civilian programs have been initiated in advance of the growth in Treasury tax revenues available to finance them. The problem would be of little moment if these expenditures were relatively small, but such is not the case. Civilian uncontrollable items (except trust funds) have risen from 28 to 37 percent of the total budget between fiscal 1967 and fiscal 1974.

At the same time, growing reliance on trust-fund financing adds a regressive element to the tax system. The payroll tax, which is a flat percentage of wages at or below the wage base, hits the lower-paid worker proportionately harder than the higher-paid employee. Payroll-tax revenues have jumped in recent years and now account for 26 percent of total receipts. In the process, they have replaced the corporate tax as the second largest revenue source—they accounted for two-thirds more revenue than the corporate tax in 1972—although they still rank substantially behind the individual-income tax in this respect.

The '69 experience

The problem of controllability first was raised explicitly with the publication of the fiscal 1969 budget

(January 1968), when heavy Vietnam war expenditures were superimposed on a fully employed economy. The Administration and the Congress met that crisis by imposing a 10-percent surcharge on individual and corporate income taxes, and also by acting to hold controllable civilian expenditures at the previous year's level.

Thanks to these measures—but largely to the tax increase—the \$25-billion fiscal '68 deficit was transformed into a \$3-billion surplus in fiscal 1969. Yet, that experience also revealed that with \$119 billion tied up in the uncontrollable category, only about one-third of the total budget could be brought under the expenditure ceiling—the necessary second pincer in the two-pronged attack on the deficit.

Again \$25 billion

Today, five years later, budgetmakers are again faced with the task of overcoming a \$25-billion deficit (fiscal 1973), but they have encountered little sentiment in favor of a tax increase as a solution to the problem. At the same time, they must deal with the fact that the budget share of relatively controllable items has dropped from 36 to 25 percent between 1969 and 1974—and with the fact that the growth of non-trust fund civilian outlays has continued to

outpace the growth of available revenues.

This situation, if continued, could lead to a highly inflationary succession of Federal deficits under conditions of full employment. This explains the Administration's determination to get controllable items truly under control, by imposing a ceiling which ensures that new programs and expanded programs can be funded with the normal growth of Treasury revenues.

This also explains the unanimity of opinion, expressed in the just-released annual report of the Congressional Joint Economic Committee, in favor of a spending ceiling at the \$269-billion level proposed by the Administration. Wide disagreements still exist concerning the components of that total; thus, the Democratic majority suggests that "Congress should make major reallocations within the Administration's proposed expenditure total." Still, the JEC's annual report marks the growing Congressional acceptance of the need for a Congressionally-imposed spending ceiling as a means of controlling the budget and curbing inflationary pressures.

Herbert Runyon